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FINANCIAL INCLUSION IN INDIA

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ABSTRACT

\The pursuit of building accessibility of financial services at affordable costs to all individuals irrespective of their net worth and size is the basis of the concept of financial inclusion. Financial inclusion strives to address challenges that exclude people from participating in the financial sector. Financial inclusion is a fundamental cornerstone of economic and social development. The concern of GOI has been on the overall inclusion of various sectors towards development. Various initiatives like rural employment guarantee scheme, Bharat Nirman, Sarv Shiksha Abhiyaan and PMJDY are a move to propel the target of financial inclusion. The paper is an attempt to provide an understanding of the concept, comparison of financial inclusion and exclusion and thereby appraise the achievement of this goal in India using two indicators; ATMs and Commercial bank branches. The trends suggests that financial inclusion has increased over the study period (2007-2015), yet it leaves scope for inclusion of other indicators for the same. The focus is on economic & social inclusion in general through financial inclusion in particular so as to term the current economic growth as inclusive growth.

KEYWORDS: Financial Inclusion, financial services, ATMs and Commercial Banks.

Introduction

The biggest challenge that the nation faces today is the inclusive growth. To ensure that the Indian economy grows rapidly, all segments of society should propel this growth process, preventing any regional disparities from derailing such growth. Thus, there is an urgent need today to provide financial services to all households that are excluded from formal financial services. So the financial sector becomes the only sector that has the ability to act as a facilitator and multiplier for overall economic growth and stability. A well spread out financial system engenders economic activity by mobilising savings into the formal financial system, providing an avenue to urban workers to remit money to their families in villages besides weaning them away from the clutches of money lenders. Inclusion connects all parts of the country to the market economy and mitigates risks by ensuring that the poor have access to a variety of social security products, like micro-savings, micro-credit, micro-insurance, and micro-pension products.

Financial Inclusion, broadly defined, refers to "universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products (The Committee on Financial Sector Reforms, Chairman: Dr.Raghuram G. Rajan)."

Indian banking system has exhibited tremendous growth in extending its reach, coverage and delivery of financial products to the masses since decades. Several factors such as culture, financial literacy, gender income, assets etc affect access to formal banking system in any country. RBI and the government of India have taken several measures since Independence to improve the access to affordable financial services through

a) financial education,
b) leveraging technology and
c) Generating awareness.

Such efforts can be traced back to the 1960's when the focus was on channelizing of credit to the neglected and weaker sections of the population. The government of India nationalised the banking operations of few commercial banks in two phases in 1969 and 1980. RBI also initiated by laying down priority sector lending requirements for banks, establishment of Regional rural banks, self-help group linkage programme, setting of local area banks etc. The RBI set up a commission (KHAN Commission) in 2004 to look into financial inclusion and its recommendations were incorporated in to the mid - term review of the policy (2005 – 06). In India, financial inclusion was introduced in 2005, as a pilot project in union territory of Pondicherry by Dr K.C Chakraborty, the chairman of Indian Bank. Mangalam village became the first village in India were the all the households were provided with the banking facilities.

The eleventh five year plan (2007 – 2012) envisioned inclusive growth as a key policy objective. The plan document suggested that economic growth had failed to be sufficiently inclusive, particularly after the mid 1990's. Though the Indian economy achieved high growth rates between 2003 – 2004 and 2007 – 2008, it did not result in the reduction of unemployment and poverty levels. Thus 11th plan tried to restructure the policies in order to make growth faster, broad - based and inclusive.

Financial Exclusion and Financial Inclusion defined

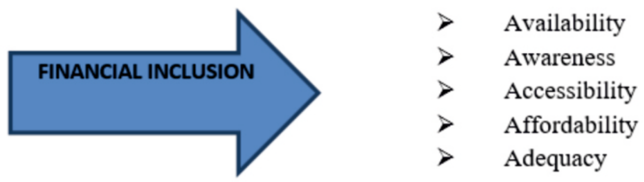
A large segment of the society in developing countries has a very little access to formal and informal financial services. Due to which many of them have to depend either on their own saving or the high cost of informal sources of finance. Despite the rapid spread of banking over the years, a large chunk of population is excluded from the formal financial system. The marginal farmers, landless labourers, unorganised sector employees, migrants, women are excluded from the financial sector which leads to marginalisation and the denial of opportunity for them to grow and prosper.Access to financial services is essential for citizens to be economically and socially integrated in today's society. It is also a requirement for employment, economic growth, poverty reduction and social inclusion.So the priority of the government today is to move the left out proportion of population from unorganised to organised financial system.

Financial system plays a very important role in promoting economic growth and development through the aspect of financial intermediation by channelling funds from the surplus unit to the deficit unit of the economy. Many studies have concluded that financial development tends to increase economic growth with the twin objective of reduction in poverty and inequality.

A well-functioning financial system drives economic growth, creates a platform for financial intermediation by providing savings, credit, payment and risk management products to people with a wide range of needs.

Financial inclusive system allow an easy, broad based access to financial services by making customised banking products available at an affordable price without stringent documentation, particularly to the poor or other disadvantage groups in the economy

Five A's of Financial Inclusion



RBI defines Financial Inclusion as "process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular." RBI gave three guiding principles for achieving inclusive growth – financial inclusion, financial stability and financial literacy. With the main objective of financial inclusion, RBI focussed on the other two pillars as foundation for attaining inclusive growth.

Fig1–Financial Inclusion Tripod (Financial Stability: Issues and Challenges (2009): valedictory address by Dr. D. Subbarao, then governor of RBI)

India in 2008 had a focus on financial inclusion, but due to abrupt collapse of Lehman Brothers in September 2008, this aspect of growth did not receive its due attention. D.Subbarao, the then governor of RBI asserted that financial stability has to be shifted from being an implicit variable to an explicit variable of economic policy. The need for financial literacy got due attention when Rangarajan committee focused on improving the demand for financial services apart from supply side or delivery services. Thus financial literacy will help to identify and use appropriate financial products and services to build and preserve the assets over time. With three important pillars for inclusive growth, RBI came up with financial inclusion tripod as a tool to inclusive growth of the economy. This is shown in fig1.

In June 2013, CRISIL first time published a comprehensive financial inclusion index (viz.,Inclusix). For constructing the index, CRISIL identified three critical parameters of basic banking services namely branch penetration[1], deposit penetration[2] and credit penetration[3].

The CRISIL Inclusix suggested an overall improvement in financial inclusion in India. CRISIL –Inclusix (on a scale of 100) for India increased from 35.4 in March 2009 to 37.6 in March 2010 and to 40.1 in March 2011.

The Concept of GDP Growth

Economic growth is an increase in the capacity of an economy to produce goods and services, compared from one period of time to another.Economic growth can be measured in nominal terms, which include inflation, or in real terms, which are adjusted for inflation i.e. by the percent rate of increase in the gross domestic product (GDP). The increase in real GDP shows that there is increase in the value of nation output or national expenditure. So the economy which is producing more, indicate that it is a growing economy. Economic growth can be either positive or negative. Negative growth means that the economy is shrinking. Negative growth is associated with economic recession and economic depression.

According to C.P. Kindle Berger, "Economic growth means more output and economic development implies both - more output and changes in the technical and institutional arrangements by which it is produced".

Well-functioning institutions and markets augment technological innovation, capital accumulation and hence the economic growth. Well-developed financial markets lower the costs of transaction which lead to increase in the amount of savings and thus investment. The capital is allocated to the projects that yield the highest returns and therefore enhance GDP growth rates.

The paper treats the aspect of financial inclusion as a proxy for efficient capital allocation for financial sector and hence a propeller of economic growth for Indian economy. This relationship is analysed and tested for its statistical significance.

The relationship between Financial Inclusion and GDP Growth revisited

There is a general consensus among economists that financial development spurs economic growth. According to Adam Smith (1776), banking operations allow the country's industrial development. So a reliable financial system shall lead to massive economic development.

According to Schumpeter, the theory of development states that given the rate of population, the dynamic evolution of capitalist economy is determined by the rate of innovation, entrepreneurial talent and credit institutions. Entrepreneur or innovator is the key figure in Schumpeter analysis of the process of development. He comprises the central place in the development process because he initiates development in a society and carries it forward. So a well-developed financial sector is absolutely necessary, if entrepreneur are to be successfully engage in the process. New projects require financing because the upfront investment cannot always be carried by the entrepreneur. Without a well-functioning financial sector, innovation would be impossible which will result in little economic growth. So, financial inclusion is a necessary condition for growth. Not only does it provide innovative financial products but also encourage low income earners to save more.

Solow growth model (1956) focuses on short run and medium run effects of improvement in financial development. The key component of economic growth is saving and investment. An increase in saving and investment raises the capital stock and thus raises the full employment income and product. The Solow model shows that increase in saving rate will lead to higher level of output per worker in steady state. The economy develops more as she moves from one steady state to the other, with people experiencing a higher per capita level of income after which the economy again stabilises at the steady state growth rate. So the savings rate plays an important role in increasing an economy's social welfare.

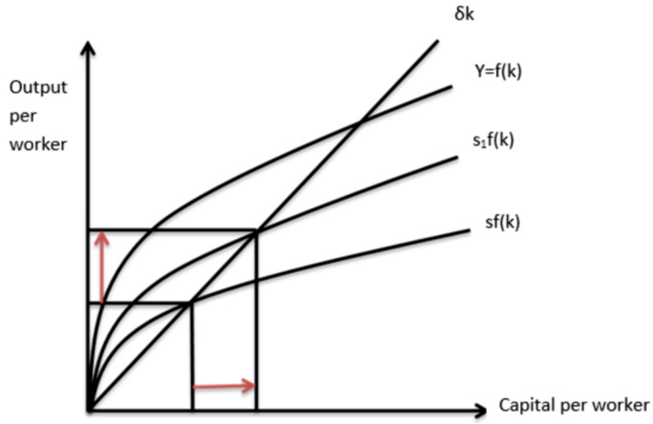
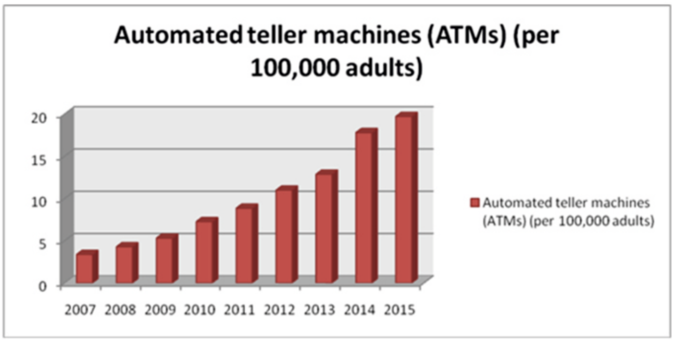


Fig2 – Effect of saving on capital accumulatin and output

Like other economies, Prof. Solow also considers that the underdeveloped economy is dual economy. This economy consists of two sectors-capital sector or industrial sector and labour sector or agricultural sector. In industrial sector, the rate of accumulation of capital is more than rate of absorption of labour. In agricultural sector, real wages and productivity per worker is low. To achieve sustained growth, the capital labour ratio must be high and underdeveloped economies must follow Prof. Solow to attain the steady growth. This is indicated in the figure 2; as savings increase from s to s1, capital per worker increases and the economy moves to a higher level of economic growth.

The above literature however fails on account of practical application. Hence, the paper revisits the trends relating to various aspects of Financial Inclusion in India using following parameters:

1) Number of ATMs as a proxy for financial inclusion:



Graph 1: ATMs per 100,00 adults (source: World development indicators, World Bank)

A well-functioning financial inclusion target needs convenient customer access to their various accounts. According to reports published by the World Bank, the unbanked population for the world dropped by 20% between 2012 and 2014. During the same period the unbanked population for India dipped by 25% (around 180 million).This happened due to the aggressive PMJDY (Pradhan Mantri Jan Dhan Yojana) scheme which forced banks in India to open zero balance accounts of the unbanked & give debit cards against these accounts. Though such accounts had garnered deposits worth Rs.187 billion, till 2015, more than 50% of these remained zero balance accounts.

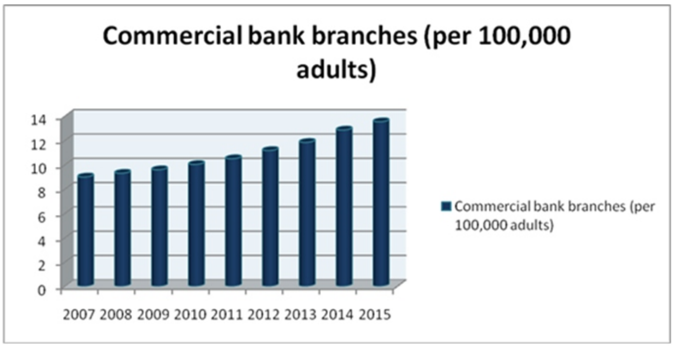
The Government of India is insisting the funding of these accounts by introducing Direct Benefit Transfers (DBT) wherein the subsidies given to the citizens for gas, kerosene etc., will directly be credited to their accounts.

While increasing number of accounts of the unbanked population are being opened, the challenge remains that of empowering convenient access to such accounts by the account holders, who are largely located in remote areas lacking adequate infrastructure. Banks currently have been following multiple approaches of deploying branches, ATMs and micro-ATMs to reach these account holders. But this is not enough, given the vastness of the country.

Although the aim is to reduce the dependence on cash, yet the numerous socio-economic-political issues in the country will tend to hold cash as a major means of exchange even in the foreseeable future. And the most economical channel to supply cash on a self-service mode, are the ATMs.

In India, cash being a dominant means of transactions, ATMs installed in remote locations can warrant that the holders of the PMJDY accounts can withdraw the subsidies credited into their accounts, through the ATMs. A large number of ATMs in India has reduced the operational hassles and cost for banks and helped in the expansion of ATMs in the remote corners of the country. However, the infrastructure and operative issues enumerated above continue to be a cause of concern for the same.

2) Commercial bank branches in India as a proxy for financial inclusion:



Graph 2: Commercial bank branches per 100,00 adults (source: World development indicators, World Bank)

For the success of the financial inclusion initiative what is important is to provide banking services at an affordable cost to the disadvantaged and low income group. Commercial banks have to perform a vital role in this regard. However the road towards 100% financial inclusion is yet to complete since the number of commercial bank branches is limited in response to population. The trends seen in Graph 2 above suggest an increase in the number of bank branches for commercial banks indicating efforts towards financial inclusion. This is a positive yet incomplete step to propel the goal of financial inclusion. Important areas of financial inclusion performed by commercial banks are: financial literacy, Credit counseling, KYC norms, Branch expansion, Mobile banking, and other measures such as micro insurance, micro- credit etc. The very expansion of bank branches indicates the outreach of policy efforts towards attainment of the goal of financial inclusion in India through above parametes.

Financial Inclusion: An Appraisal

Benefits of Financial inclusion

Economy as a whole benefits through financial inclusion (Mohan, 2006).Access to safe, easy and affordable credit and other financial services by the poor and vulnerable groups, disadvantaged areas and lagging sectors is termed as precondition for accelerating growth and reducing poverty and income inequality.

A developing country benefits from financial inclusion in the following ways

1. **Reduction in income inequality:** Financial development not only promotes economic growth but can also help divide it more evenly. Financial Inclusion is an important tool to reduce income inequality in the economy. Low income individuals are often not able to access financial services. These individuals have a greater potential to improve their income levels by providing access to various services. Better access to credit by the poor enables them to pull themselves out of poverty by investing in their human capital and microenterprises, thus reducing aggregate poverty. Financial depth has a significant impact on poverty reduction through channels such as entrepreneurship and the inter-state migration of workers towards financially more developed states

2. **Promoting entrepreneurship:** Providing young people with financial services can help promote entrepreneurship and asset building, and emphasize sustainable livelihoods. By introducing scheme of Standup India and Start up India, the aim of government was to convert the earlier moto from job seekers to job creators which will transform the lives of people and hence will promote entrepreneurship.

3. **Implementation of Anti money laundering:** Financial inclusion helps to move people from cash economy to the bank accounts which can be monitored. It facilitates the implementation of anti money laundering and combating the finance of terrorism.

4. **Economic growth:** Financial services and financial development stimulates economic growth by increasing the rate of capital accumulation and by improving the efficiency with which economies use that capital in present and future.

5. **Higher and better productivity:** Productivity and innovation are directly linked to the financial development. The innovative activities are capital intensive and tend to require outside financing which is more effective with a relatively more developed financial sector. Thus financial development facilitates technological innovations and low cost production methods that boost the productivity.

6. **Increase in employment and income opportunities:** Financial inclusion is closely intertwined with the process of financial sector development. The inclusion means access to banking and thus the services need to be closer to where the people are offering deposit-taking, payments processing, microfinancing, mortgages, insurance. In other words, all of the products and services that fuel investment create jobs and stimulate growth.

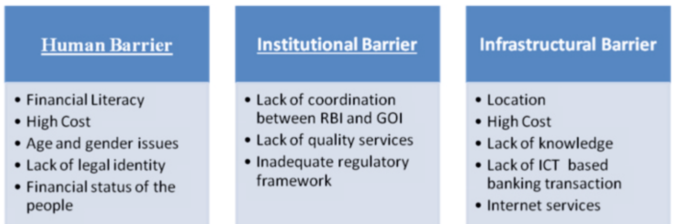
7. **Rational utilisation of savings:** The financial inclusion develops the habit of saving among all the sections of the society. The people from rural areas either spend their money or keep it at homes which donot provide any return. But with the provision of banks or financial institution at nearby place they can save the money and use it at the time of emergency.

8. **Faster growth in the economy:** In the developing economies where the majority of the people is excluded from the benefits of the financial services, the financial inclusion will foster the savings of the rural people and which in turn will help in the capital formation and growth of the country as a whole

9. **Smoothing consumption:** Consumption smoothing is very critical for the poor who face various hardships. These problems can be avoided when people can save gains made during the good times and borrow at reasonable rates during bad times. Lack of access to formal credit has been a hurdle for poor to engage in consumption smoothing. The farmers uses their productive asset to maintain their subsistence level of consumption. With the lauch of various schemes such as Jan DhanYojana, has encouraged the poor households towards inculcating sound banking habits.

Key Challenges / Barriers to Financial Inclusion

The significant proportions of the households, especially the rural areas are still outside the formal fold of the banking system. CRISIL highlighted the three big challenges of financial inclusion ie high cost, lack of robust technology and lack of awareness in its report released by Indian chamber of commerce in May 2011. Some of the barriers are listed below in the figure.



It further pointed out that a paradigm shift in thinking was required and that financial service providers must see inclusion as opportunity rather than an obligation.

Literature review

CRISIL (2015) measured the extent of financial inclusion in India in the form of an index. The methodology of CRISIL Inclusix is similar to other global indices such as UNDP's Human Development Index and measures financial inclusion on the three critical parameters of basic banking services – branch penetration, deposit penetration and credit penetration. The index uses parameters that focus only on the number of people whose lives have been touched by various financial services, rather than on the amount of deposits or loaned. The key findings of the report were as follows – All India CRISIL Inclusix registered a score of 50 % at the end of Fiscal 2013; MFI were also included in index computation ; saving accounts grow faster in 4 years. The CRISIL hence provided the ground level information regarding the progress of financial inclusion in the country.

Dr. MM Gandhi[4] (2013) attempts to develop an overview of approaches and trends in Indian economy in international perspective for achieving inclusive growth in financial inclusion. The extent of financial exclusion was found to be higher as compared with other developed and emerging economies (World Bank, Financial Access Survey, RBI,2012) in the form of Number of bank branches, No of ATM's, Bank credit and Bank deposits. State wise index of financial inclusion (RBI working paper on financial inclusion in India, 2011) found that Kerala, Maharashtra and Karnataka have high extent of financial inclusion as compared to the other states. Although there has been an improvement in outreach activity in the banking sector, but the achievement was not found to be significant.

Dr Laha, Dr kuri[5] examined inter – state variation of financial inclusion from the angles of demand and supply of financial services. The empirical results suggested that the extent of demand for and supply of financial services in urban areas is comparatively higher than rural India .It was further observed that the

low demand for financial inclusion has an important bearing on the supply of low financial services. In other words, the demand for financial inclusion greatly affect the supply side financial inclusion. So it wass recommended that merely supply of financial services would not ensure a comprehensive financial system in an economy, unless it is supplemented by generation of demand for financial services. Some suggested demand side measures are: emphasis on human development, access to land, enhancement of employment opportunities, development of rural infrastructure, enhancement of agricultural productivity, implementation of agricultural risk mitigation programme.

Sarma (2012) attempts to examine the relationship between financial inclusion and development. An index of financial inclusion (IFI) was used which was developed in Sarma (2008) to investigate macro level factors that can be associated with financial inclusion. The paper attempted to understand the relationship between IFI and the Human Development Index (HDI), the most widely used development index. It was found that level of human development and that of the financial inclusion are strongly positively correlated, with the few exceptions. Among the banking variables, the proportion of non - performing assets was inversely associated with the financial inclusion. The CAR(capital asset ratio) was found to be negatively associated Government ownership and interest rate did not have significant effect on financial inclusion

Gupte,Venkataraman and Deepa Gupta aims to study the determinants that measure the extent of financial inclusion and focuses on the computation of an index that would comprehensively capture the impact of multi-dimensional variables with specific reference to India using the data from world bank. This paper computed the financial inclusion index for India as a geometric mean of four dimensions – outreach (penetration and accessibility), usage, ease of transactions and cost of transactions.The factors ease and cost of transactions helped to view the financial inclusion more holistically. As compared to the estimates using Sarma methodology the study computed much higher values for Financial inclusion index This study showed FII in India has improved from 2008 to 2009 and can be attributed to several initiatives taken by financial regulators, the government and banking industry. RBI took the financial inclusion initiatives in a 'mission mode' through a combination of strategies ranging from introduction of new products, relaxation of regulatory guidelines and other supportive measures to achieve sustainable and scalable financial inclusion.

Dr Sahu (2013) did the study on the present status of India's financial inclusion, estimated the financial inclusion index for various states in India and observed the relationship between Financial Inclusion Index and Socio-economic Variables. His study concluded that 72.7 percent of India's 89.3 million farmer households are excluded from formal sources of finance. While constructing the index of financial inclusion (IFI), a multidimensional approach was followed which is similar to that used by UNDP for computation of some well-known development indexes, such as the HDI, the HPI, the GDI etc..In India no state belongs to high IFI group. The two states namely Chandigarh and Delhi belong to medium IFI, and rest of the states have low IFI values. The coefficients of Per Capita Net State Domestic Product (PNSDP) is positively associated with financial inclusion. Regression results reveal that 34 percent of the change in financial inclusion index is explained by per capita net state domestic product.

Conclusion

Financial inclusion is a fundamental cornerstone of economic and social development. The concern of GOI has been on the overall inclusion of various sectors towards development. Various initiatives like rural employment guarantee scheme, Bharat Nirman, Sarv Shiksha Abhiyaan and PMJDY have attempted to propel the target of financial inclusion. The paper is an attempt to appraise the achievement of this goal of financial inclusion in India using two indicators; ATMs and Commercial bank branches, yet it leaves scope for inclusion of other indicators for the same. The focus is on economic & social inclusion in general through financial inclusion in particular so as to term the current economic growth as inclusive growth.

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Footnotes:

1. Bank branch penetration is measured as number of bank branches per one lakh population
2. Measured as number of saving deposit accounts per one lakh population
3. Average of three measures (namely number of loan accounts per one lakh population, number of small borrower loan accounts per one lakh population and number of agriculture advances per one lakh population) used for credit penetration.
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